

ICPS newsletter

Budget Resolutions: Effective Planning Mechanisms or a Waste of Time?

As part of the overall budget process, the Ukrainian parliament currently uses budget resolutions to inform the Cabinet of Ministers about its budget priorities. However, such resolutions have proved to be neither substantive nor realistic, and have had little impact on the final budget document, calling into question the rationale of their continued use. Mr. Peter Ricoy, advisor on budget analysis to the Fiscal Analysis Group at Barents Group, believes that if such documents were initiated by the Cabinet of Ministers and agreed to by the Parliament at the initial stage of budget formulation, budgets would correspond more to strategic priorities and ministries would be more informed on the realistic constraints to their work

Why are budget resolutions necessary?

Not every country makes use of budget resolutions, and those that do have different concepts of how budget resolutions work. In the United States, the budget resolution essentially serves as a means for providing an aggregate fiscal constraint, helping to prioritise spending across broad functional areas, and providing planning for future years. It is not necessary for Ukraine to follow the U.S. model of budget resolutions. However, in considering its own use of budget resolutions, the experience in the United States provides a few principles that may help to guide Ukraine on the formation of its own use of budget resolutions. There are two primary areas where the use of budget resolutions may be helpful in Ukraine:

- Budget resolutions can be an effective device for considering and setting overall levels of government spending, revenues, and deficits, and thus for **providing an overall budgetary constraint**. With no overall constraints on spending in place, policymakers are not forced or able to rigorously consider the relative tradeoffs of spending on different programs when making decisions.

- Budget resolutions can be an effective mechanism for providing **longer-range budgetary planning**. A short-term budget focus that only considers the next fiscal year may contribute to spending decisions that do not adequately address needed longer-term solutions.

A lesson of the budget resolutions used in both the United States and New Zealand is that they present the long-range implications of the government's overall fiscal policy and deficits. In both resolutions, a multiple-year forecast is provided for revenues, expenditures, the deficit, and the debt. This allows policymakers to better understand the implications over the longer term of running deficits. In other words, it establishes an overall budgetary constraint early in the budget process. This is important for two reasons. First, it helps policymakers to understand that they cannot simply fund everything they would like without there being long-run consequences. Furthermore, it helps budget agencies to see more clearly the medium-term outlook, and to understand the importance of medium-term planning.

What would be the important components of budget resolutions in Ukraine?

Consistent with the ideas of budget resolutions in other countries, there are three important components that could be included in budget resolutions in Ukraine:

- 1. Defining strategic objectives.** The approach of defining objectives has been successfully employed by New Zealand. The idea is to clearly separate the overall strategic objectives that policymakers would like to achieve from the particular inputs or policies that they choose. The objective is to generate a basic consensus on the major goals of the budget policy.

- 2. Defining overall fiscal policy indicators.** The starting point of the process

is a "baseline" forecast, which shows policymakers the forecasted level of these overall fiscal policy indicators over a multiple-year period, assuming that the current policies in effect stay the same. Thus, revenues are forecasted based on the continuation of the current laws that establish taxes. Expenditures are forecasted slightly differently, depending if they are "mandatory" (such as interest servicing of debt, or pension payments) or "discretionary" (such as wages for personnel or expenditures on computers), but the idea is the same: the forecast for expenditures assumes that the current policies continue.

- 3. Defining broad budgetary principles and priorities.** In the United States, the overall expenditure total is actually divided up among very broad functional expenditure categories, such as defense, health, and education. In New Zealand, on the other hand, such a breakdown does not occur in the Budget Policy Statement. Rather, the Budget Policy Statement expresses in words the areas of priority, such as "extend economic and social opportunities", and "improve the quality of the regulatory environment".

What determines the effectiveness of budget resolutions?

In order to successfully implement the use of budget resolutions in Ukraine, there are two key concepts that help the budget resolution work effectively in the United States: access to a considerable amount of budget information, and the ability to enforce the mechanisms of the resolution.

- Construction of budget resolutions in the United States **requires clear and unbiased information**, including projections of the macroeconomic context in which the country is expected to operate, projections of the future budgetary outcomes under current law (baseline budgets), information from the executive on their spending requests, and information about how proposed changes in policy would effect the baseline for spending or revenues (budget estimates).

· In the United States, the budget constraint as set out by the budget resolution is effective only to the extent that **its guidelines are followed and enforced by the Congress**. The example of the U.S. shows that budget resolutions do not necessarily have to have the force of law to be effective, as long as the rules are enforced within the legislative branch. This may be especially important in Ukraine, where the actual budgets passed in recent years have shown little resemblance to the budget resolutions passed. Such divergences between the budget resolution and the actual budget undermine the role of the resolution, and call into question the value of the Rada's time spent in putting it together.

Should the resolutions be produced by the legislative or executive branch?

In the United States, the budget resolution is prepared by the Congress, while in several other countries, such as New Zealand, it is prepared by the executive. Part of this difference is explained by the nature of different government systems: in the U.S., the Congress is an entirely separate branch of government whose members are not part of the executive, and which has the authority to initiate its own legislation. In New Zealand, the government is a Westminster-Parliamentary system whose majority or coalition Members of Parliament are also members of the government and select the Prime Minister. In this respect, Ukraine's government is closer to the U.S. system.

last Week

Latest Transformatsiia. A new issue of the bimonthly bulletin *Transformatsiia*, a Russian-language version of the World Bank's *Transition* newsletter about reforming economies, was published last week, containing the following topics:

- economic effects of the Kosovo crisis;
- economic education in Central and Eastern Europe;
- trade and exchange rate policies in Kazakhstan;
- China's rural reform;
- EU accession process;
- analysis of economic crisis in Cuba;
- applying target inflation levels in monetary policy;
- active labour market policy in transition countries;
- new views on the causes of Russia's economic woes.

If you wish to receive the bimonthly bulletin *Transformatsiia* regularly, please send your information to the e-mail address: marketing@icps.kiev.ua or contact Oleksii Blinov, ICPS marketing office, tel. (380-44) 463-6337

Background on use of budget resolutions in Ukraine and how they can be affected by the Budget Code

According to the budget process in Ukraine, the Verkhovna Rada is required to adopt budget resolutions by June 15th each year. The budget resolution is supposed to contain:

- guidelines of the Cabinet of Ministers for the formulation of budget policy;
- an outline of priorities of the budget policy;
- principles for the state regulation of Ukraine's economic and social development;
- principles for interbudgetary relations.

The budget resolution was designed to provide information to the Cabinet of Ministers for its formulation of the draft budget, which must be submitted to the Verkhovna Rada by September 15.

Although the Cabinet of Ministers is supposed to take parliamentary resolutions into account, they themselves do not have the force of law, and the Cabinet of Ministers is permitted to deviate from the resolution, as long as it mentions and justifies all such deviations in the draft law on the State Budget.

At the same time the Budget Code passed by the Verkhovna Rada on May 19 suggests that the status of budget resolutions would be elevated from that of a resolution to a law. Article 89 states that "the budget resolution and budget proposals are mandatory for consideration". Article 130 suggests that the Parliament can reject the draft budget on the basis of non-compliance with the budget resolution.

As envisioned by the budget code, the budget resolution would still be a short-term document, focusing only on the next budget period. The Verkhovna Rada would still continue to put together the budget resolution.

However, there are many peculiarities that should be understood about the U.S. system, and there are also reasons why the application of the U.S. system of legislative preparation of the budget resolution would not be appropriate for Ukraine. First, in the U.S., although the document is prepared by the Congress, it does not place any requirements on the budget that the executive branch puts together. Furthermore, Congress is able to put together the budget resolution by itself because it has access to the most important information and resources needed to put together such a resolution.

The Verkhovna Rada of Ukraine does not have access to the same support agencies as the executive. It has no independent capability to produce macroeconomic forecasts, create budgetary baselines, or conduct cost and revenue estimates. Without this critical information and institutional support, it is unrealistic to believe that the Ukrainian parliament would be able to put together a very substantive document.

On the other hand, the Cabinet of Ministers not only has the necessary analytical and institutional capability to put together such a document, but would also benefit by getting more involved in defining the strategic principles of budget policy. These principles could be sent directly from the Ministry of Finance, for example, to the agencies as they formulate their budgets. Furthermore, the

establishment of an aggregate, top-down fiscal discipline early in the budget process in other countries has been shown to produce more favourable budgetary outcomes.

Under the proposed approach, the Cabinet of Ministers of Ukraine would put together the document at an early stage, and submit the results to the Verkhovna Rada. The formulation of the Budget Resolution would have to start much earlier, like in April. After submitting the document to Parliament, any debate between the Cabinet of Ministers should be over broad budgetary principles or overall budgetary aggregates. Parliament should have the opportunity to vote on the budget resolution and to send a message to the Cabinet of Ministers about its overall broad priorities. However, the result of the Parliament's vote should not be binding, but rather should provide information to the Cabinet of Ministers about what are the preferences of the Parliament. The Cabinet of Ministers should use this information to understand the political climate and attempt to strategically formulate the budget to respond to the most important priorities.

A seminar on "The Role of Budget Resolutions" was held as a part of the ICPS's Centre of Policy Excellence (budget policy) project on July 31, 1999. The presentation was made by Peter Ricoy, advisor on budget analysis to the Fiscal Analysis Group at Barents Group

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To be included in the distribution list mail to: marketing@icps.kiev.ua.

ICPS Publications Director Hlib Vyshlinsky (hlib@icps.kiev.ua)

ICPS Newsletter Editor Yevheniya Yehorova (ee@icps.kiev.ua)

English text editor D. (Ksenia) Ovcharenko

Articles may be reprinted by ICPS consent

Address: 8/5 Voloska Street, Kyiv, 254070, Ukraine

Phone (380-44) 462-4937/38/58. Fax (380-44) 463-5970

Web-site: <http://www.icps.kiev.ua>